VZCZCXRO0110
RR RUEHDA
DE RUEHAK #2183/01 1110435
ZNR UUUUU ZZH
R 210435Z APR 06
FM AMEMBASSY ANKARA
TO RUEHC/SECSTATE WASHDC 4985
INFO RUEATRS/DEPT OF TREASURY WASHDC
RHEHAAA/NSC WASHDC
RUEHIT/AMCONSUL ISTANBUL 0350
RUEHDA/AMCONSUL ADANA 0667
RUEHBS/USEU BRUSSELS

UNCLAS SECTION 01 OF 02 ANKARA 002183

SIPDIS

TREASURY FOR INTERNATIONAL AFFAIRS - CPLANTIER

SIPDIS

SENSITIVE

E.O. 12958: N/A
TAGS: EFIN TU
SUBJECT: Central Bank Governor Appointed and Social Security Legislation Passed

Ref: Ankara 2049 and Previous

1.(SBU) Summary: On April 18, President Sezer approved the nomination of a new Central Bank Governor, ending months of speculation and uncertainty. The new Governor is a well-regarded career central banker, though his reputed ties to the ruling Justice and Development Party (AKP) raise concerns about Central Bank independence. On April 19, Parliament finally succeeded in passing the long-awaited, IFI-supported social security reform legislation, despite an opposition boycott of the proceedings. These two achievements pave the way for another IMF review and perhaps a change in Turkey's credit rating. The economic outlook for 2006 remains favorable, with risks principally in the domestic political arena. End Summary.

Central Bank Governor Appointment Resolves Uncertainty

¶2. (SBU) On April 18, President Sezer's office announced that he had approved the Government's nomination of Durmus Yilmaz to be Central Bank Governor. The appointment resolves months of frenzied speculation in the press and fretting by market analysts about who the new Central Bank Governor would be. The speculation was exacerbated by the Government's messy handling of the process and the rejection by President Sezer of the Government's nomination of the CEO of an Islamic Bank to be Governor.

¶3. (SBU) In the end, the GOT and Sezer agreed on 26-year Central Bank veteran Durmus Yilmaz. Yilmaz was a member of the Bank board and of its interest-rate setting Monetary Policy Committee. Current and former Central Bank employees tell us he is well-liked and well-regarded within the Bank. He has good relations with former Governor Serdengecti but he is also reputed to have ties to FonMin Gul from their studies in the UK in the early 1980's. Sezer's approval of Yilmaz disproves speculation that a Sezer would reject any candidate with a headscarved wife, since Yilmaz' wife wears a headscarf. Most market analysts were positive about the appointment, citing Yilmaz' long experience, although a Goldman Sachs analyst said the appointment raised questions about Central Bank independence.

Social Security Legislation (Finally) Passes

¶4. (SBU) On April 19 Parliament passed the long-awaited and

highly controversial social security reform legislation. The legislation will institute universal health insurance, but will also gradually reduce the deficits of the state-funded pension system, by raising retirement ages and adjusting pension formulas. This legislation has long been the single most important structural reform under the IMF program and delays in its passage have put the program on hold (reftel). In the end, the AKP Government succeeded in overcoming opposition delaying tactics only by using an extraordinary, expedited procedure, causing the opposition People's Republican Party(CHP) to boycott the proceedings. The passage of the law despite CHP and violent street protests (which were dispersed by police gunfire in Ankara), shows that the AKP has the discipline and parliamentary majority to make hard reform decisions when it wants to.

IMF Mission and Possible Rating Upgrade

¶5. (SBU) In public comments April 20, both Economy Minister Babacan and IMF Resrep Hugh Bredenkamp said they expected an IMF mission to come to Turkey very soon, now that the social security legislation has been passed. Though the mission will still need to deal with the GOT's decision to cut Value-added tax rates for the textile sector, the IMF and GOT are expected to find a way forward, allowing the third review to go to the IMF board and the accompanying loan tranche to be disbursed.

¶6. (SBU) The market-friendly news also reopens the

possibility that the rating agencies will upgrade Turkey's sovereign credit rating. At the beginning of the year, Fitch had implied it would upgrade Turkey once the social security legislation was passed. S&P was also thought to be considering an upgrade. Moody's, on the other hand, has tended to adjust its ratings much less frequently, and Turkey analyst Kristin Lindow played down the likelihood of a change on April 20.

Positive Outlook for 2006

¶7. (SBU) With markets reassured by the Central Bank appointment and the expected return of the IMF mission, the outlook for the remainder of 2006 is mostly positive. Most analysts expect continued strong GDP growth in 2005, exceeding the 5% target. While the Central Bank is expected to have its work cut out for it in achieving the ambitious 5% inflation target, most analysts expect it will at least come close. Foreign Direct Investment, which is badly-needed to provide long-term financing to Turkey's large current account deficit, not to mention to bring jobs and technology transfer, is expected to remain at the high level Turkey experienced in 2005. With installment payments on 2005 acquisitions still flowing in, and several new deals announced in 2006, total FDI is expected to be roughly comparable to last year's $9.6 billion. The Turkish state is also much less vulnerable to problems rolling over its debt, with yearend 2005 Net Public Debt to GDP below 60%. Stubbornly high unemployment remains a problem, since Turkey's economy is not creating jobs as quickly as the growth in the potential labor pool.

But Risks Remain

¶8. (SBU) Though the current outlook for the economy is quite positive, Turkey is vulnerable to sudden shifts in market

sentiment. Though unlikely to lead to a full-blown crisis, a sharp shift could be disruptive, leading to a sharp recession, for example. One risk remains Turkey's large and growing current account deficit, which surpassed 6% of GDP in 2005 and is likely to be slightly larger in 2006. Turkey's dependence on short-term portfolio investment to finance the current account deficit means a sudden shift in sentiment could be damaging, though in recent years investors have tended to wait out market corrections.

¶9. (SBU) Perhaps the greatest area of risk to the economy and market confidence arises from the political arena. With elections due in 2007, Turkish politicians are already in election mode, with the attendant risks of populist pandering on economic policies. Tensions between the AKP Government and the secularist establishment have increased recently, increasing the possibility of a politically-disruptive clash that would unnerve businessmen and financial market investors. In addition, markets are very sensitive to instability in Turkey's volatile region or to tensions between Turkey and the EU.

Wilson